

Charges for shipping are gross receipts subject to ROT when they are part of the selling price of the tangible personal property being sold. See, 86 Ill. Adm. Code 130.415. (This is a GIL).

June 2, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated April 21, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is a STATE converting machine manufacturer whose machines produce products ranging from sealable food storage pouches to padded mailing envelopes. We currently sell and service machines in the United States and many foreign countries.

I am writing today in accordance with our local laws, to request information about the sales tax laws of your state. To simplify this process, I have enclosed a questionnaire that deals with the sale and maintenance of our machine if sold to a customer in your state. The return of this questionnaire with your signature, title, along with your state seal or stamp will be greatly appreciated. Your official response will be held on file and will bring us into compliance with our laws.

When reviewing the enclosed questionnaire, please keep in mind that COMPANY always retains ownership of its machinery until it is completely installed at the buyer's facility, and the last payment is received. If your answer to these seven questions is either taxable or non-taxable, please circle the appropriate response. If the answer to any question requires an explanation, please circle enclosure and send us the pertinent information you have on that subject. If all seven questions are answered non-taxable, because your particular state has no sales tax, please indicate this in the comment field.

I would like to thank you in advance for your time and effort in completing this information for us, and for your prompt response.

Your questions regarded the taxation of the following:

1. Machine transportation costs from CITY/STATE to a purchaser in your state

2. Machine purchase of \$200,000.00 or more
3. Spare parts, costing between \$5.00 and \$3,500.00 each, which are **purchased and delivered with a machine**
4. Labor costs charged for our technicians making service or repair visits **after the machine is installed within a facility in your state**
5. Repair or replacement parts, costing between \$5.00 and \$3,500.00 each, which are **sold after a machine is in service within a facility in your state**
6. Large capital improvements to the machine costing over \$10,000
7. Separate labor costs for technicians installing capital improvements

We are answering your questions in narrative form in order to provide detailed explanatory material on the items about which you have made inquiry.

The question of whether transportation costs or freight charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such transportation or freight charges but upon whether the charges are included in the selling prices of the property or are contracted for separately by purchasers and retailers. To the extent that such charges exceed the costs of shipping, transportation or delivery, the portion of the charges that exceed the actual shipping costs are subject to tax. The best evidence that transportation charges are agreed to separately and apart from selling prices is separate and distinct contracts for freight or shipping. Alternatively, documentation in the records of sellers that purchasers had options of taking delivery of the property at sellers' locations, for the agreed purchase prices, or having delivery made by sellers for the agreed purchase prices plus ascertainable delivery charges, may suffice. Please refer to 86 Ill. Adm. Code 130.415, enclosed.

The sale of tangible personal property, including machinery, in Illinois to end-users is generally subject to Retailers' Occupation and Use Tax liabilities, unless one can document an exemption. The tax is measured by gross receipts. The selling price of the item sold does not affect the determination of the taxability of the transaction. In general, Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease.

The manufacturing process is the production of articles of tangible personal property, whether such articles are finished products or articles for use in the process of manufacturing or assembling different articles of tangible personal property by procedures commonly regarded as manufacturing, processing,

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fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant. See 86 Ill. Adm. Code 130.330(b)(2), enclosed. Please note the exemption does not apply to hand tools, coolants, lubricants, solvents, apparel, adhesives and similar supplies. The exemption is available for replacement parts purchased for exempt machinery or equipment, Section 130.330(c)(3).

In order to document the exemption, the user of such machinery and equipment must supply an exemption certificate to the retailer as provided in 86 Ill. Adm. Code 130.330(g)(1). The user may provide an active registration or resale number in lieu of the prescribed certificate. If a machine qualifies for the exemption, an addition or improvement to the machine would also qualify so long as the resulting machine meets the above stated requirements.

Illinois Retailers' Occupation Tax is imposed upon gross receipts from the sale of tangible personal property to end-users and gross receipts is defined to mean all the consideration received by sellers valued in money whether received in money or otherwise, but not including the value of or credits given for like kind traded-in property. In computing Retailers' Occupation Tax liability, no deductions shall be taken by a taxpayer from gross receipts on account of the cost of the property sold, the cost of materials used, labor costs, or any other expense whatsoever. See 86 Ill. Adm. Code 130.410, enclosed.

Regarding repair or service visits made by your technicians after you sell a machine and it has been operating within Illinois, you have not stated whether this work is pursuant to maintenance agreements. Please be aware that the taxation of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the company making the repair or providing the service will be acting as a service provider under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See part (3) of subsection (b) of the enclosed copy of 86 Ill. Adm. Code Sec. 140.301.

If repair or service work is done that is not pursuant to a maintenance agreement, the transaction would be subject to liability under the Service Occupation Tax Act. Under the Service Occupation Tax Act, servicemen are taxed on

tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If the servicemen do not wish to separately state the selling price of the tangible personal property transferred, the servicemen must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Serviceman may qualify as de minimis if the servicemen determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to the sale of service. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

Please be advised both the Service Occupation Tax Act and the Use Tax Act have provisions that exempt machinery and replacement parts used directly in a manufacturing process as discussed above.

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I hope this information is helpful. The Department of Revenue maintains a Web site which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Karl Betz
Associate Counsel

KB:msk
Enc.